

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

In the Matter of)	
)	
Application by SBC Communications Inc.,)	
Southwestern Bell Telephone Company, and)	
Southwestern Bell Communications Services,)	CC Docket No. 01-88
Inc. d/b/a Southwestern Bell Long Distance for)	
Provision of In-Region, InterLATA Services in)	
Missouri)	

REPLY AFFIDAVIT OF PHILIP G. NAUGHTON

STATE OF TEXAS)
)
COUNTY OF BEXAR)

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DEPRECIATION AFFIDAVIT**

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1. My name is Philip G. Naughton. My business address is 1010 N. St. Mary's, Room 11-V-03, San Antonio, Texas 78215.
2. I graduated from Cleveland State in 1975, with a BA degree in Economics.

Subsequently, I attended The Ohio State University, completing undergraduate accounting courses. I am a Certified Public Accountant and a member of the American Institute of Certified Public Accountants.

3. I am employed by Ameritech Services Inc. (“Ameritech”) as Area Manager – Capital Recovery. I have 10 years experience with SBC/Ameritech, including acting as a Senior Internal Auditor, Regulatory Manager, Finance Manager, and Capital Recovery Manager. I have been in my current position of Area Manager – Capital Recovery for three years; I am responsible for capital recovery for numerous SBC subsidiaries, including Southwestern Bell Telephone Company (“SWBT”).
4. The purpose of my affidavit is to reply to CLEC allegations, in the depreciation portion of their comments, that SWBT should use FCC rather than financial accounting lives in UNE proceedings.
5. AT&T asserts that SWBT must use the depreciation lives from an inapposite FCC ruling. Use of these lives in Missouri, however, is inappropriate because they are not forward looking, are based on physical obsolescence, and rely on outdated equipment life ranges. SWBT has relied on the Missouri Staff-approved economic lives that properly consider that technological rather than physical obsolescence now is the major factor driving a plant’s economic life. The MPSC’s approach is consistent with the Kansas/Oklahoma Order, which agreed that the SWBT financial accounting lives used in Oklahoma were appropriate, and also stated that FCC lives did not have to be used in these proceedings.¹
6. The CLECs and DOJ do not agree with the benchmarking study completed in Missouri in the 1997 proceeding. Their criticisms are flawed because: (1) the FCC states in the Local Competition Order that the depreciation rates used in calculating

¹ Memorandum Opinion and Order, Joint Application by SBC Communications Inc., et al., for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, FCC 01-29, ¶ 76 (rel. Jan. 22, 2001).

forward-looking, economic costs of elements should be economic depreciation rates;²

(2) the TELRIC rules state that embedded costs should not be used;³ and (3) the

Intrastate, Interstate, and FCC permitted range columns of Mr Baranowski's Table 1,

the foundation of AT&T's and the DOJ's criticisms, clearly relate to the entire plant

base (which, by definition, improperly include embedded costs). See AT&T's

Baranowski Decl. at Table 1. Accordingly, the MPSC, in 1997, properly decided to

adopt SWBT's proposed economic lives with minimal changes.

7. Use of the MPSC's economic lives will allow SWBT to appropriately recover its forward-looking costs of providing services. Today, due to greatly increased competition, technological change comes very quickly. It is the competitive market demand for the newest features and functions that controls the economic life of telephone equipment, rather than the physical durability of that equipment, as was the case under rate of return regulation. Customer interests are best served by allowing the forces of competition to make the economic determinations that are automatically made by a competitive market.
8. Accordingly, the MPSC properly adopted the only TELRIC-based depreciation lives with which it was presented. This concludes my affidavit.

² First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499, 15856, ¶ 703 ("Local Competition Order"), modified on recon., 11 FCC Rcd 13042 (1996), vacated in part, Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), aff'd in part, rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999), decision on remand, Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000), cert. granted, 121 S. Ct. 877 (2001) ("We conclude that an appropriate calculation of TELRIC will include a depreciation rate that reflects the true changes in economic value of an asset and a cost of capital that appropriately reflects the risks incurred by an investor.").

³ Local Competition Order, 11 FCC Rcd at 15857-59, ¶¶ 704-07.

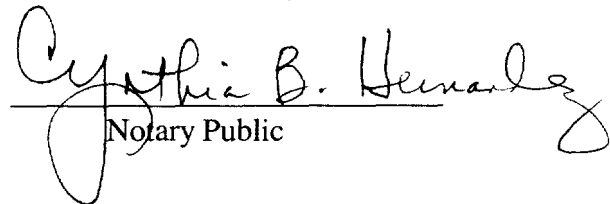
I hereby swear and affirm that the information contained in the attached affidavit is true and correct to the best of my knowledge and belief.



Philip Naughton

STATE OF Texas)
COUNTY OF Bexar)

Subscribed and sworn to before me on this 14 day of May 2001.


Notary Public



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)
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I, Barbara A. Smith, being first duly sworn upon oath, do hereby depose and state as follows:

1. My name is Barbara A. Smith. I am Director – Cost Analysis and Regulatory at SBC Telecommunications Inc. My business address is One Bell Center, Room 38-Y-3, St. Louis, MO 63101. I am the same Barbara A. Smith who filed an affidavit in this docket on April 4, 2001.

I. Purpose of Affidavit

2. The purpose of this affidavit is to reaffirm that Southwestern Bell Telephone Company (“SWBT”) relied on forward-looking costs in support of its interconnection, unbundled network element, collocation, and reciprocal compensation offerings in Missouri, consistent with Federal Communications Commission (“FCC”) rules and 47 U.S.C. § 271(c)(2)(B) of the Telecommunications Act of 1996 (“the Act”), as interpreted and applied by the Missouri Public Service Commission (“MPSC”).
3. Specifically, my affidavit reiterates that SWBT’s costs developed for Missouri for unbundled network elements were developed in accordance with the Act, 47 U.S.C. § 251(c)(3)(4)(6) and § 252(d)(1). I will explain, consistent with my affidavit filed on April 4, 2001, that the basis for these cost studies (and the methodology used to determine the costs for these elements) comply with the FCC’s forward-looking Total Element Long Run Incremental Costs (“TELRIC”) principles. I will rebut the assertions of the Department Of Justice (“DOJ”), AT&T, and WorldCom, that SWBT’s costs, and the prices ordered by the MPSC, do not reflect the forward-looking costs of providing those elements. I will also show that SWBT’s costs are not embedded costs.
4. I will respond to baseless cost and pricing criticisms of AT&T declarant Michael Baranowski and WorldCom declarant Christopher Fentrup. Specifically, Messrs. Baranowski and Fentrup have made demonstrably false allegations regarding electronic access to SWBT’s cost studies and false allegations of non-TELRIC inputs in the loop and local switching studies, and they have relied on invalid comparisons of UNE prices across different SWBT states.

5. Both AT&T's and WorldCom's declarants ignore well-settled FCC precedent by engaging in scattershot criticisms of the MPSC's lengthy and thorough cost proceedings. As this Commission has written: "under the national pricing rules that we adopt for interconnection and unbundled network elements, states will retain the flexibility to consider local technological, environmental, regulatory, and economic conditions."¹
6. Because these declarants cannot identify any MPSC errors in the application of TELRIC principles or in factual matters that resulted in prices falling out of the range the reasonable application of TELRIC would produce,² the declarants rely on FCC proxies that were never intended to usurp a state commission's well-reasoned and thorough price determinations. As a preliminary matter, the FCC's synthesis model, by the FCC's own assertion, is improper for setting prices. See Morrissey Reply Aff. Moreover, the model can only be employed when clear errors by a state commission have been established,³ or in cases where a state commission will not set prices. In Missouri, neither is the case. As discussed below, there have been no violations of basic TELRIC principles or "clear

¹ First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd 15499, 15558-15559, ¶ 114 (1996) ("Local Competition Order"), modified on recon., 11 FCC Rcd 13042 (1996), vacated in part, Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), aff'd in part, rev'd in part sub nom. AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366 (1999), decision on remand, Iowa Utils. Bd. v. FCC, 219 F.3d 744 (8th Cir. 2000), cert. granted, 121 S. Ct. 877 (2001).

² See Memorandum Opinion and Order, Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Kansas and Oklahoma, CC Docket No. 00-217, FCC 01-29, ¶ 59 (rel. Jan. 22, 2001) ("Kansas/Oklahoma Order") ("[W]e will not conduct a *de novo* review of a state's pricing determinations and will reject an application only if 'basic TELRIC principles are violated or the state commission makes clear errors in factual findings on matters so substantial that the end result falls outside the range that the reasonable application of TELRIC principles would produce.' States also 'retain the flexibility to consider local 'technological, environmental, regulatory, and economic conditions.'") (quoting Local Competition Order, 11 FCC Rcd at 15558-59, ¶ 114).

³ This is not to say that cost studies must be flawless. As this Commission observed: "Because states have considerable flexibility in setting UNE rates, certain flaws in a cost study, by themselves, may not result in rates that are outside the reasonable range that a correct application of [] TELRIC rules would produce." Kansas/Oklahoma Order ¶ 81.

errors in factual findings on matters so substantial that the end result falls outside the range that the reasonable application of TELRIC principles would produce.”

Kansas/Oklahoma Order ¶ 59.

II. Access to SBC's Cost Information

7. WorldCom (at 5) and AT&T (at 15) state that SBC has not carried its burden because it has not provided access to its cost models and inputs.⁴ This is patently untenable. SBC provided the same cost information in its Missouri 271 filing as it did for Texas, Kansas, and Oklahoma. This information included the cost studies that were used as a basis for the rates in Missouri.⁵
8. Now, in an effort to distract this Commission from the MPSC's lengthy, thorough, and diligent cost proceedings, WorldCom and AT&T, *for the first time*, raise complaints about not having access to electronic versions of SBC's cost studies. Not surprisingly, during the 271 hearings in Jefferson City in October and November 2000, this complaint never was raised before the MPSC. Had it been, it would summarily have been dismissed.
9. As a preliminary matter, WorldCom and AT&T were active participants in the cost portion of Texas Mega Arbitration, which spanned a 16-month period in 1996 and 1997,

⁴ The DOJ parroted AT&T's and WorldCom's criticism without foundation in its evaluation of SWBT's Application. See DOJ Evaluation at 14, fn. 47.

⁵ SBC had not previously provided any of these cost studies in electronic format except in response to specific requests from the FCC Staff. At the FCC Staff's request in this docket, on April 23, 2001, SBC provided the inputs used for the UNE Loop Cost Study, the CAPCS model, populated with the Missouri capital cost inputs, and the ACES spreadsheets, modified into an EXCEL format.

the same time period in which the MPSC reviewed SWBT's cost studies in Missouri. (After the first phase of Texas Mega Arbitration, AT&T appeared to take the lead in the rest of the SWBT state arbitrations, while WorldCom elected not to participate.) During the Texas Mega Arbitration, the Texas Commission ordered SWBT to provide the CLECs with training and access to SWBT's cost models. These are the exact same models that were used in Missouri and the other SWBT states. As a result of the order, during the week of January 27, 1997, SWBT held a five-day training course in Austin, Texas to train CLEC personnel on the SWBT models and SWBT cost studies. The CLECs had access to electronic and paper versions of SWBT's cost studies. During this week-long training course, 19 people from AT&T and MCI attended. After the workshop in Texas, mini workshops were held in February and March. During the second phase of the Texas Mega Arbitration, nearly one hundred Subject Matter Experts, who provided inputs to the SWBT cost studies, were deposed. Accordingly, the rather absurd notion that AT&T and WorldCom cannot fully understand SWBT's cost studies and cost models (without the help of computers they had access to during the relevant adversarial proceedings) should be rejected. See, e.g., Kern Reply Aff. (chronicling active participation by the CLECs in T0-97-40).

10. Moreover, during the AT&T Arbitration in Missouri (Case No. TO-97-40), AT&T and MCI were given access to SWBT's cost information. The traditional nondisclosure agreement was revised to allow employees of AT&T and MCI access to the cost studies. The cost studies were sent to Austin, Texas to allow AT&T and MCI greater access. Also, during the hearings in Jefferson City during October 1996, the cost studies were made available to AT&T and MCI via a Proprietary Room in the Capitol Plaza Hotel.

The reply affidavit of Mr. Alan Kern provides additional detail as to the AT&T and MCI personnel that had access to SWBT's Missouri cost studies in 1996. See Kern Reply Aff.

III. SWBT's Cost Studies Filed in Missouri Comply with TELRIC Principles

11. In short, the notion that WorldCom and AT&T were unable to examine and understand the cost studies without having electronic access to the models is patently untenable and outright false.⁶ SWBT submitted the same cost models in all the SWBT states. WorldCom and AT&T had ample opportunity to understand the cost models and the inputs. Moreover, AT&T and WorldCom had open access to SWBT's cost studies in Missouri – e.g., during TO-97-40.
12. In my April 4, 2001 affidavit in this docket, I stated in significant detail that the SWBT cost studies submitted to the MPSC comply with 47 U.S.C. § 252(d)(1), which requires that prices for interconnection and unbundled network elements be “based on the cost” of providing these elements, products, and services, and “may include a reasonable profit.” The Local Competition Order prescribed a methodology for identifying the costs on which these prices should be based. The FCC's methodology is the sum of TELRIC and a reasonable allocation of forward-looking common cost.
13. In its January 22, 1997 Order in TO-97-40, the MPSC ordered four members of the Staff of the MPSC (“Staff”) to participate in a review of SWBT's cost studies commencing in

⁶ Notably, Mr. Fentrup makes the claim that he can't examine the cost studies without having electronic access while he apparently had no trouble calculating the feature related hardware percentage of investment by reviewing the paper copy of the local switching study. Mr. Fentrup also complains that SBC did not make the outputs of SCIS available for review in this proceeding, yet it was the outputs of SCIS that he used to calculate the percentage of hardware factor. See WorldCom's Fentrup Decl. ¶ 22.

February 1997.⁷ This review lasted for 16 weeks. While SWBT did not agree with all the input changes recommended by the Staff, and complained of due process problems, the format of the review led to the Staff's understanding of the cost models, the cost inputs, and the cost studies.

14. During the 16-week review process, SWBT's cost study personnel met with the Staff and walked the Staff through the studies, including the cost models, the model assumptions, and the inputs, among numerous other calculations. During these meetings, Staff had the opportunity to ask clarifying questions and ask for additional information, which they did. The Staff was provided all model documentation and electronic versions of the models to test inputs.
15. During this review period, the MPSC Staff also met with AT&T's and WorldCom's experts. The initial purpose of these meetings was for AT&T and WorldCom to provide the Staff with information about the Hatfield model. However, during these meetings, the Staff, AT&T, and WorldCom discussed SWBT's inputs and assumptions in the Missouri cost studies.
16. During this very same period, the Texas Mega Arbitration was underway. AT&T and WorldCom were completing discovery on SWBT's models (*the same models used in Missouri*) and filing hundreds of pages of comments with the Texas Commission on each

⁷ Order Granting Clarification and Modification and Denying Motion to Identify and Motions for Rehearing, AT&T Communications of the Southwest, Inc.'s Petition for Arbitration Pursuant to Section 252(B) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company, et. al., Case Nos. TO-97-40; TO-97-67 (MO PSC Jan. 22, 1997) (App. G, Tab 10 to our initial application).

cost model and cost study. During the 16-week review by the Staff, SWBT was questioned about many cost issues pertaining to the model used in Missouri that had been raised by the CLECs in Texas.

17. With all the cost information provided by SWBT and the CLECs regarding SWBT's Missouri TELRIC studies, the Staff formed its own opinion regarding the correct inputs and recommended changes to SWBT's TELRIC studies. These revised cost studies were submitted to the Staff on June 9, 1997, and an Order with permanent prices was issued in July 1997.⁸
18. In its review of SWBT's cost studies, the Staff rejected the AT&T/MCI cost standard that assumed a "scorched earth" approach. The AT&T/MCI cost approach, in effect, sought to design the network from the ground up. The Staff believed that the most appropriate cost standard "is the use of forward-looking economic cost assuming the existing network were being rebuilt today to meet forward-looking levels of demand. This approach includes the use of the latest technology currently deployed in the existing network."⁹ Accordingly, AT&T's assertion that the MPSC's costing methodology was calculated toward "reproduc[ing]" rather than "replac[ing]" the existing network is belied by the facts. See AT&T at 13.

⁸ Final Arbitration Order, AT&T Communications of the Southwest, Inc.'s Petition for Arbitration Pursuant to 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company, Case No. TO-97-40 (MO PSC Jul. 31, 1997) (App. G, Tab 11 to our initial application).

⁹ Final Arbitration Order, Att. C at 3, AT&T Communications of the Southwest, Inc.'s Petition for Arbitration Pursuant to 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company, Case No. TO-97-40 (MO PSC Jul. 3, 1997) ("Costing and Pricing Report") (App. G, Tab 11 to our initial application).

IV. The Missouri Cost Studies for Loop and Switching Are TELRIC-Compliant

19. WorldCom and AT&T declarants, Fentrup and Baranowski respectively, incorrectly assert that the Missouri cost studies for loops and switching are not TELRIC-compliant. The inputs for these studies were all TELRIC-based, as outlined in the Local Competition Order. Moreover, the MPSC did not agree with SWBT with regard to numerous inputs; and the MSPC ordered input changes to SWBT's cost studies – to further ensure TELRIC compliance. SWBT subsequently appealed these changes to the District Court and the 8th Circuit. While the 8th Circuit agreed with SWBT's initial interpretation of TELRIC, SWBT agreed to maintain the more CLEC-friendly prices in the Missouri 271 Agreement (M2A) which are based on the MPSC's TELRIC analysis in TO-97-40.

V. Local Switching

Switch Discounts

20. Both WorldCom and AT&T criticize the switch vendor discounts ordered by the MPSC, claiming that the discounts are not TELRIC-compliant.¹⁰ WorldCom incorrectly concludes that the discounts are wrong because the FCC, in its model, chose only to use initial discounts, as opposed to initial and growth discounts. See WorldCom's Fentrup Decl. ¶ 17. Mr. Baranowski states that initial discounts are the only correct choice for a TELRIC study because of the "scorched node" assumption and that "all assets necessary to service demand...would have to be newly purchased." AT&T's Baranowski Decl.

¹⁰ Relying solely on AT&T's and WorldCom's analyses, the DOJ opines that the MPSC made a "questionable decision[]" with regard to switch discounts. DOJ Evaluation at 14. As the following discussion illustrates, the MPSC appropriately set switch discounts.

¶ 36. Contrary to these assertions, however, the proper switch discount derives from a proper weighting of initial and growth discounts.

21. Switching Cost Information System (“SCIS”), SWBT’s switching cost model, is programmed to use the switch discounts as an input to the model, expressed as a percentage. The switch discount is the effective discount from the vendor’s list price – the list price often changes at the vendor’s election. It actually consists of two discounts: (1) a system discount; and (2) a volume discount. The discount is determined based on signed agreements with the switch vendors (Lucent and Nortel). The discount is then used in SCIS to discount the vendor’s current list prices for equipment. The discounts may vary between users and tend to be unique to each user, as are the prices and the pricing approach.
22. SWBT developed switch discounts using a weighted mix of switch discounts for initial placements of switching equipment and growth jobs to add new line equipment. The prices and the discounts were extracted from SWBT’s procurement contracts with its switch vendors, and a weighted average discount for each vendor was derived from contract information.
23. Staff’s Costing and Pricing Report (at 32) concluded that SWBT received discounts in addition to those used in SWBT’s original local switching studies. To determine the discount, Staff reviewed vendor contracts, Firm Price Quotes (“FPQ”), which are prices for a specific job, and purchase orders. Based upon a review of this information, Staff proposed a different discount for both Nortel and Lucent switches. From this

information, it derived augmentations to SWBT's discount measures that resulted in discounts of ** ** for Lucent (up from ** ** originally filed) and ** ** for Nortel (up from ** ** originally filed). The correct calculation for the discount includes a weighting of growth and replacement discounts. Staff's recommended discounts are close to what SWBT would have calculated using this methodology. SWBT's original local switching studies proposed in Missouri yielded a price per line of ** **. After the Commission-ordered adjustments were made to the local switching study, the price was ** ** per line. AT&T, at the same time, was proposing a \$115 price per switched line in Texas.

24. WorldCom and AT&T propose a discount methodology based on initial jobs only (although there is no actual discount percentage proposed), and which treats all switching investment as initial, resulting in a higher discount and a lower switching investment. AT&T and WorldCom assume a "flash cut" of switch investment at a single point in time. With their proposal, all switches, in whichever stage of their life cycle, would be modeled and priced as if they were placed today. SCIS models the switching network as it exists at the relevant point in time. SCIS develops investment for existing demand which consists of switches in different stages of their life cycle (which accurately reflects SWBT's network). In SWBT's network, there is a certain percentage of switches that are relatively new and a certain percentage of switches further along in their life cycle. One cannot physically "flash cut" and replace the entire network, which is the practical effect of what WorldCom and AT&T propose, by using the discounts received on initial switch placements.

25. When a switch is bid for a dial-to-dial replacement or a new wire center, the company will get the lowest price from the vendors. This is what WorldCom and AT&T are proposing, a “flash cut” of all switches in the network, bid out at the lowest price. In an actual network, there are a certain percentage of switches that are relatively new. There is no economic incentive to replace these switches. Realistically, no one would ever consider bidding all switches out in a network for total replacement, especially a new entrant, because its entry is likely to be staged. There are also new lines that must be added to the switches at some point in time and these lines will be added at a much higher price (a lower discount would be applied). The mixture of initial placements and growth jobs is a realistic depiction of a dynamic network. SWBT’s existing switches, at the various points in their life cycles, are a snapshot of the same. A properly forward-looking network will have a similar mixture of different aged switches.
26. AT&T also complains that the discounts were not appropriately applied to the Engineering and Installation prices within the SCIS model. As explained to the Staff, SWBT’s vendor contracts used as a basis for the material switch prices did not contain discounts for Engineering and Installation, only for Material, therefore it would be inappropriate to apply discounts to Engineering and Installation.
27. Mr. Fentrup states that “the FCC determined that it should use only the discounts offered for initial switch purchases.” WorldCom’s Fentrup Decl. ¶ 17. This was appropriate, the Commission concluded, because initial switches reflected cost-effective, forward-looking technology. This passage, however, does not support Mr. Fentrup’s conclusion because

the FCC explicitly stated that the inputs in the Synthesis Model were not to be used for purposes other than Universal Service.

28. This passage needs to be understood in the context of the FCC's Universal Service Tenth Report and Order, which culminated in the FCC's determination of Universal Service costs applicable for the federal high cost support for non-rural local exchange carriers.¹¹ The most pertinent determination made by the FCC in this proceeding was that, even though state commissions may decide otherwise, the FCC did not use company-specific switch investment data. Instead the FCC decided to use public data to develop nationwide switch average investments. The public data used by the FCC has its limitations. The BOC data used by the FCC include investments for lines. However, the data also include investments for switch upgrades caused by necessary changes to meet industry and regulatory requirements such as the expansion of the North American Numbering Plan, which accommodates the introduction and expansion of CIC codes, and the introduction of the 888 code. Unfortunately, the investment effects of upgrades, compared to lines added to existing switches, could not be disentangled using the data set. Given the late date of the determination of inputs for the federal model, the FCC demurred and excluded any investment for a switch that was not sufficiently close in time to the original placement of the switch. In short, the FCC did not possess the means to combine temporally dispersed switch investments in order to develop nationwide average prices for a hypothetical, efficient firm. Accordingly, the FCC's results are inappropriate

¹¹ See Tenth Report and Order, Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, 14 FCC Rcd 20156 (1999) ("Universal Service Tenth Report and Order").

for a TELRIC study.¹² In fact, the FCC “caution[ed] parties from making any claims in other proceedings based upon the input values [switch prices] we adopt in this order.”

Universal Service Tenth Report and Order, 14 FCC Rcd at 20172, ¶ 32.

29. Accordingly, AT&T’s and WorldCom’s arbitrary application of language and data from an inappropriate FCC order cannot and should not supplant the MPSC’s thorough, accurate, and relevant switch discount evaluation. As discussed above, the MPSC adopted a discount that, almost by definition, is TELRIC-compliant.

Feature Related Hardware

30. The term “Feature Related Hardware” (“FRH”) means the hardware components needed to provide features (e.g., 3-port conference circuits necessary to provide 3-Way Calling) that are not part of the SCIS Model Office reports (which were used to develop the total investment for the local switching cost study). Because FRH is part of the total switch investment and is not included within the SCIS model office, SWBT calculated the costs outside the model and added the FRH to the total switching investment.
31. WorldCom and AT&T incorrectly assert that the methodology used to calculate FRH overstates the cost, and that the Staff ordered no changes to the FRH factor.¹³ SWBT used the Continuing Property Records (“CPR”), a system that keeps a record of the

¹² The Synthesis Model uses publicly available depreciation data to develop switching investment. This approach “will eliminate switches whose book values contain a significant amount of upgrade costs, and recognizes that, when ordering new switches, carriers typically order equipment designed to meet short run demand.” Universal Service Tenth Report and Order 14 FCC Rcd at 20289, ¶ 315. This mention of “short run demand” is a direct violation of the TELRIC rules which require the element under study be representative of total demand.

¹³ Again relying on AT&T and WorldCom comments, the DOJ indicated that another “possible error[] that may have affected the Missouri switch prices include SBC’s particular application of the ‘hardware factor.’” DOJ Evaluation at 15. As discussed below, this is not the case.

physical inventory of each central office and includes the price paid for each piece of equipment in that office, to identify FRH. This system is *required* by FCC Rule 47 C.F.R. § 32.2000(E). The CPR is the basis for the total historical investment in switching depicted in annual reports to various agencies. It is this hardware which is provisioned as part of the unbundled local switching element. SWBT used this method to identify the quantities and investment of FRH that existed in each central office. SWBT began with historical investment for the FRH, and converted it to current investment using a Current Cost to Booked Cost Ratio.

32. WorldCom's and AT&T's incorrect assertion that no adjustments were made to FRH is belied by the Staff report. After the MPSC Staff's review of the Local Switching Cost Study, several changes to the Feature Related Hardware methodology were recommended and subsequently adopted. The first modification required applying the FRH factor only to the study's 5ESS and DMS100 switching investment. The factor was based upon FRH for these two types of switches, but then was applied to all switching investments, including DMS10 and Ericsson. Staff recommended applying the factor to the DMS100 and 5ESS switching investment in the study and applying the factor only to non-line investments. See Costing and Pricing Report at 43.
33. Staff expressed concern regarding possible double counting of the input/output ports, but these items are not included in the SCIS model so there is no double counting. However, regarding the allegation of double counting, Staff made the following statement in its report: "[t]herefore, SWBT should not be allowed to charge separately for any of the functionality provided by the equipment included in the hardware factor." See Costing

and Pricing Report at 43. Accordingly, the notion that SWBT was able to double count investments again is belied by the Staff's order that addressed and resolved the issue.

34. The cumulative effect of all Staff's recommended changes to the Unbundled Local Switching Cost Study was a reduction of costs by 64 percent.

VI. Unbundled Local Loop

SBC's Loop Cost Studies Are Forward-Looking and Do Not Replicate the Existing Network

35. AT&T and WorldCom incorrectly assert that SBC's cost studies simply "replicate" or "reproduce" the existing network. This allegation is entirely false. SBC has developed cost studies based on a forward-looking methodology, using forward-looking network designs, efficient technology, and current vendor contracts. The methodology and network designs used to develop the loop study are forward-looking and derive a loop cost that is substantially below the costs that would result if SBC relied on the existing network.
36. For example, in the real existing network, the vast majority of loops (roughly 90 percent) are copper loops. In SBC's UNE loop study, the ratio falls to a more economical **
- ** split. This is because, within the study, all loops that are longer than the copper/fiber breakpoint are assumed to use a fiber-based digital loop carrier ("DLC") system. Because SBC uses this assumption, the use of very expensive 22- and 19-gauge cable, which is deployed in the existing network in order to maintain signal integrity, is completely ignored in the study. SWBT instead assumes that these longer loops, which